

Vietnam: Laying the Foundation for Sustainable, Inclusive Growth

Vietnam is one of the fastest-growing economies in the world. It is going through a far-reaching transformation from an inward-looking planned economy to one that is globalized and market-based. It has the potential to be one of the great success stories in development

Country Indicators	1993	2007	Most Recent Est.
GNI per capita (Atlas Method, US\$)	170	790	1,010 (2009)
Inflation (CPI, annual rate, %)	8.4	12.7	6.5 (2009)
External debt (% of GNI)	191	34.3	36.4 (2009)
Poverty incidence (% of population with consumption below basic needs level)	58	15.9 (2006)	14.5 (2008)
Net primary school enrollment rate (%)	77 (1990)	97 (2006)	98 (2008)
Under-five child mortality rate (per 1,000 live births)	53 (1990)	25.9	25.5 (2008)
Maternal mortality rate (per 100,000 live births)	200 (1990)	75	75 (2008)
Population (millions)	70.3	85.2	86.0 (2009)
Population growth rate (% per year)	2.0	1.09	1.06 (2009)

Source: Vietnam, General Statistics Office and Ministry of Health; World Bank, Development Data Group.

Real income has grown 7.3 percent per year over the last 10 years. When the World Bank reengaged with Vietnam in 1993, income per capita was US\$170. In 2008, gross domestic product (GDP) per capita crossed the US\$1,000 mark. The poverty rate has fallen from 58 percent in 1993 to 14.5 percent in 2008. Vietnam can reach most of the Millennium Development Goals.

Vietnam is a major recipient of resources from the International Development Association, although it is not an aid-dependent country. The World Bank co-chairs with the government the Consultative Group Forum that over the years has helped mobilize aid in support of Vietnam's development and has supported dialogue between Vietnam and Development Partners on various issues.

Country Achievements

Vietnam's development achievements have been remarkable.

By the mid-1980s, ravaged by war and a failing command economy, the country faced famine. The government launched a renovation process (*Doi Moi*) in 1986, with the goal of adopting market mechanisms wherever possible while preserving social inclusion.

An egalitarian redistribution of farmland, coupled with freer trade in agricultural products and better agricultural support services at the local level, led to a boom in farm exports and a dramatic reduction in rural poverty.

Foreign investment grew as the domestic entrepreneurial spirit was unleashed. Urban residents moved into paid employment, helping to reduce the number of rural poor even more.

Vietnam's economy expanded rapidly. It avoided the economic collapse that other transition economies went through in the early 1990s. It also managed to sustain positive growth rates during the East Asian crisis of the late 1990s and the more recent global financial crisis. In spite of the slowdown associated with the latter, Vietnam has now entered the group of lower middle-income countries.

An institutional overhaul

Vietnam's development strategy involves comprehensive reforms across all policy areas, so as to ensure business development, preserve social inclusion, manage natural resources and strengthen governance. However, reforms have not progressed at the same pace across all areas.

Much has been accomplished in relation to public financial management. Increased decentralization, improved transparency, a growing role of the National Assembly in deciding appropriations and strengthened auditing mechanisms are all part of this process. The gap between budget plans and budget execution remains large, however, and the management of public investment projects needs to be strengthened.

The introduction of common regulations and models of corporate governance for all enterprises, regardless of their ownership, has contributed to a move towards a more level playing field. Private participation has been allowed in most sectors and in state-owned enterprises. State ownership in enterprises is now being transferred out of ministries and provinces, so that those in charge of issuing or enforcing regulations do not face a conflict of interest. Less progress has been accomplished in relation to large state-owned economic groups.

Progress has been most decisive in relation to global integration. Accession to the World Trade Organization (WTO) in January 2007 resulted in lower barriers to trade. Most importantly, it opened service sectors to competition and is resulting in a thorough revamping of the legal system.

Important measures have also been taken to fight corruption. Vietnam is a country where bribes and unofficial payments put a burden on households, even if they tend to be modest by enterprise standards. An effort is underway to simplify administrative procedures and reduce red tape. Government systems are being strengthened in the most vulnerable agencies, including construction, customs, tax administration and land administration. Senior civil servants are now required to declare their assets regularly.

On the other hand, progress has been slower in financial sector reform. While the stock market and the insurance sector have developed considerably, Vietnam is still in the process of establishing a modern central bank and upgrading its capacity to supervise commercial banks and monitor international capital flows.

Private sector-led growth

The transition to a competitive market economy is well under way, driving Vietnam's growth and increasing its resilience.

Formal private enterprises, whose activities were negligible in 1993, now account for two-thirds of the investments made each year. When faced with increased domestic and international competition and a harder budget constraint, state-owned enterprises have done reasonably well.

The equitization¹ process cut the number of state-owned enterprises by more than half,

1. Vietnamese English term that denotes the conversion of a state-owned enterprise in Vietnam into a public limited company or a corporation

from 3,786 to 1,546 over the past nine years, although not across all sectors. Starting with smaller enterprises and insider privatization, the process is now reaching large general corporations and state-owned commercial banks. Remaining ownership rights by the state are being transferred out of ministries and provinces to avoid a conflict of interest between management and regulation.

As the private sector expands rapidly, both domestic and foreign-invested firms have connected solidly with global markets. Private firms now contribute nearly 80 percent of manufactured products and over 70 percent of non-oil exports. Vietnam is more and more an integral part of international production and distribution chains.

Ida's Contributions

The International Development Association (IDA), the World Bank's fund for the world's poorest countries, has helped Vietnam fight poverty through finance for agriculture, infrastructure, health programs, and schools, among other things. The country has received US\$10.9 billion in interest-free credits, grants, and guarantees from IDA, the second largest provider of aid to Vietnam after Japan.

Still, Vietnam is not aid-dependent. Foreign assistance disbursements represented only about 17 percent of total public spending or 10 percent of total public spending annually during the period from 2004 to 2008. Donors focus their efforts on policy dialogue, research, and investments in key development areas.

The Bank's partnership with Vietnam since 1993 has contributed to achieving notable results.

Supporting policy reforms

Policy dialogue arguably has had the biggest impact of all donor contributions as it underpins the reforms, which are transforming the entire economic system.

Some work has directly affected the government's programs and policies. For example, community-driven development programs funded by the World Bank, with a strong emphasis in participation, resulted in a redesign of the national target program for the most disadvantaged communes, which operate mainly in ethnic minority areas.

Nine poverty reduction support credits have now been completed with the active partici-

pation of 20 donors² and co-financing by 13 of them. These credits have supported reforms across 17 policy areas, including trade integration; financial and state owned enterprise reform; infrastructure; social sector issues (health, education, social protection); natural resource management; and governance. Specific actions in each area were sequenced carefully to match implementation capacity and exploit synergies across sectors.

Building local capacity

According to the World Bank's 2010 Country Survey, knowledge, capacity-building, and technical advice are among IDA's greatest contributions.

2. The 20 donors are: Asian Development Bank, Australia, Belgium, Canada, Denmark, the European Commission, Finland, France, Germany, Ireland, Japan, Luxemburg, the Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, the United Kingdom, and UNDP.

Some of the benefits of reforms supported by IDA credits include:

- The decision to bring strategic investors into all state-owned commercial banks.
- School quality standards that have improved the quality of teaching.
- Land user certificates that list the names of both husbands and wives, thereby allowing women to use the certificates as collateral for bank credits.
- A state budget plan disclosed to the public for the first time in 2005.
- A State Audit reporting directly to the National Assembly and effectively auditing a growing number of state-funded entities.
- A Unified Enterprises Law introducing the same set of corporate governance models for all enterprises, regardless of ownership.
- Regulation issued in 2008 on charter for first "new model" university with academic, managerial and financial autonomy.
- Legal and regulatory reforms that facilitate the move of urban water supply and sanitation companies to operate on a financially sustainable commercial basis.
- A pricing and standard contract system to grow the use of grid-connected renewable energy.
- The introduction of a market-based mechanism for electricity tariffs in 2009 started the transition to cost reflective pricing with a lifeline rate to protect the poor, ensure transparency and non-discrimination to all investors, and promote supply-side efficiency.
- Modernization of the payments system, which has made banking transactions more, secure and timely, and at a lower cost.

This has included helping to build the government's capacity to undertake research for its own purposes. For example, while the Bank conducted Vietnam's first poverty assessment, the second was undertaken jointly with the government. Now the government is doing its own, with the Bank's advice.

In education, the Bank has helped build capacity in setting minimum standards for primary education (for example in teacher qualification), the quality of teacher training, textbooks, and primary teacher competency profiles. Through a series of IDA education projects, including the Bank's first development policy credit for higher education in 2009, the government is expanding these innovations geographically and through higher levels of the education system.

Several investment credits aim to revamp business processes for more efficient use of public resources (e.g., in higher education institutions) and increased transparency (e.g., in agencies more vulnerable to corruption, including customs, tax and land administration).

Providing good-practice models

Investment credits and technical assistance—for example, on river basin management or infrastructure—have provided demonstration effects, influencing government approaches at the technical and policy levels.

IDA expertise on phasing, sequencing, and working across sectors has strengthened the effectiveness of development aid. For example, in the context of the broader infrastructure development undertaken at the national and provincial level, the government has embraced projects that are driven by

local communities rather than managed from Hanoi. Energy projects have opened the door to private participation in infrastructure. A credit to support schools in poor areas has led to nationwide standards on school quality and the regular auditing of schools against those standards.

IDA's impact is felt across sectors.

Transport: There have been remarkable improvements in rural access over the last few years. In 1998, little more than half the rural ethnic minority population of Vietnam lived close to an all-weather road, the remainder experiencing considerable isolation during wet seasons. By 2006, 91 percent of the majority Kinh population and 80 percent of the ethnic minority population resident in rural areas were living within 2 kilometers (km) of an all-weather road. IDA has financed the rehabilitation of 1,000 km of Highway One—the country's main transportation artery—with another 350 km under way. It has also provided funds to improve 600 km of another 18 national highways and to perform preventive maintenance of 1,100 km of the national highway network. IDA has also helped build more than 7,000 km of district-level roads. As a result, **6-to-8 million people have better access to the transport system**, speeding up their ability to reach markets, schools and health centers. In addition, IDA has financed the rehabilitation or dredging of 1,100 km of inland waterways in the Mekong Delta and a further 540 km is being improved in the Red River Delta.

Electricity: As a result of the government's rural electrification program, about **95 percent of rural households now have electricity** (2009) compared with just over 50 percent 10 years ago. IDA helped design this overall

effort and has supported the implementation through several projects. The first brought electricity to around 2.7 million people in poor rural areas and the second now under implementation will help connect or improve the supply for another 5.6 million. Already, this has transformed thousands of rural communities, enabling small businesses to grow and improving the services of schools and health facilities. IDA is also supporting substantial expansion and rehabilitation to the high and medium voltage networks to support industrial development and to ensure that consumers get electricity in sufficient quantity and of acceptable quality for their needs. IDA is supporting wide-ranging reforms to the power sector, to promote efficiency, and attract sufficient investment to ensure supply security and quality of service for economic growth.

Education: The primary education net enrollment rate has increased from 81 percent in 1999 to 98 percent in 2008, and the primary education completion rate from 72 to 87 percent over the same period. While the government continues to promote equity and quality of education, especially primary education, significant gaps remain, most notably between majority Kinh and minority ethnic groups. IDA has facilitated improvements in the provision of primary school services in the poorest districts: after four years of implementation, the rate of schools meeting minimum service standards increased at a rate nearly double the national average. IDA is also contributing towards reducing the learning gaps for the disadvantaged population groups by extending full day schooling. As Vietnam's economic development will be highly dependent on skills development, IDA is helping to strengthen the governance and relevance of Vietnam's higher education

system through a series of investment and policy operations. The IDA contribution to Vietnam's education sector stands at US\$788 million. Although small in terms of Vietnam's spending on education (about 2 percent), it makes a more significant contribution towards non-salary cost of education programs and development.

Health: IDA is contributing to improvements in the quality of essential health care services for more than 20 million people through three regional health support projects. These projects also support the implementation of the new health insurance law at local levels, in particular targeting the poor and near poor. IDA supports the implementation of the National Strategy on HIV/AIDS Prevention in 32 provinces, as well as the development of a National Monitoring and Evaluation Framework. IDA's contributions have included financing of regional blood transfusion centers to ensure a safe blood supply to the country and reinvigorated popular participation in voluntary blood donations, support for the national programs for malaria, tuberculosis and acute respiratory infections; essential drugs for healthcare centers; construction and upgrade of 15 health and family planning centers, 137 obstetric and operating rooms in district hospitals, and 2,500 communal health centers; and training for about 22,000 health workers in the country's poorest provinces. Under-five child mortality has dropped from 53 per 1,000 births in 1990 to 25 in 2009, while the maternal mortality rate has fallen from 200 per 100,000 births in 1990 to 75 in 2009.

Agriculture and rural development: Nearly a million loans have been provided under IDA-supported rural finance projects, enabling the upgrading of farm production

and the expansion of micro- and small rural enterprises. Millions of poor people have benefited from improved basic infrastructure and social services financed by IDA in remote areas of the central and northern highlands. An IDA-supported program is providing land use rights certificates to both spouses in some 1.5 million households. **Over 50,000 smallholder farmers** will be supported through enhanced access to markets with the provision of technology services, farmer organization, and linkages to agribusinesses. IDA is also enhancing the livelihoods of hundreds of thousands of rural households by supporting the establishment of more than 44,000 hectares of smallholder forest production and the modernization of irrigation for **over 130,000 hectares of agricultural land**. An IDA-supported project demonstrated suitable models for community-based disaster risk management, leading to a national policy change.

Urban development: The urban population is growing at 3.4 percent per year and is expected to double by 2020 and reach 50 percent by 2030. Sustainable urban development will therefore remain a central opportunity and challenge in Vietnam for many years to come. IDA assistance has supported the provision of integrated **environmental sanitation services for 2.7 million people** in many cities, including financing the country's first waste water treatment plants and introducing user fees for these services, and is continuing to finance the provision of **clean water and sanitation to over 4 million people** in several cities and towns, including Ho Chi Minh City, Da Nang, and Nha Trang as well as over a dozen smaller provinces. Projects are also under way to improve livelihoods of an additional 3 million urban citizens by providing access to basic infrastructure services,

improved flood control, access to community services such as health centers and schools, and access to micro credit loans for housing improvements, water and sanitation connections and income generating activities.

A Virtuous Circle

Infrastructure services are proving to be affordable and sustainable. The expansion of services was coordinated with budgetary and financial reforms. Rapid growth and economic diversification, in turn, have increased demand for services while allowing service providers to increase the scale of their operations and lower their costs.

Partnerships

Vietnam currently receives over US\$5 billion a year from more than 30 bilateral and multi-lateral donor institutions. The World Bank has been able to mobilize additional resources for Vietnam through co-financing or parallel financing arrangements for various investment and development policy operations.

It co-chairs consultative group meetings and the Vietnam Business Forum with the government, leads the policy dialogue, especially in relation to poverty reduction support credit operations, and increasingly fosters multi-donor credits and initiatives. This includes the public financial management modernization, education for all, International Health Partnership Plus, and forestry partnerships—all good examples of multi-donor support for government programs.³ Vietnam has made

3. The donors involved in public financial management are: Australia, Canada, Denmark, the European Commission, Netherlands and the UK. Education initiatives involve Australia, Belgium, Canada, the European Commission, New Zealand, Norway, Spain, Switzerland, and the United Kingdom. Forestry is supported by the Netherlands, Finland, the European Commission and GEF.

good progress on aid harmonization, where the six-bank initiative⁴ has been a highlighted example for working in partnership to enhance aid effectiveness.

Challenges Ahead

The global crisis has led to a noticeable slowdown in Vietnam's economic growth.

The impact was severe in the first quarter of 2009, when GDP increased by 3.1 percent compared to the same period in 2008. This is more than four percentage points below potential, given that the average for first quarter growth over the last few years has been 7.2 percent. However, growth bounced back in the second quarter, when it reached 4.5 percent. A range of indicators, from electricity consumption to retail sales, suggest that economic performance will continue to improve during the remainder of the year. Exports declined, but are holding relatively better than in other countries. Meanwhile, a timely stimulus package has effectively supported domestic demand and is leading to rapid growth in construction.

Sustaining economic growth during the global economic crisis will require stronger reliance on domestic demand.

The stimulus measures adopted by the government in 2009 included tax cuts and deferrals, social transfers and additional public expenditures, especially in relation to infrastructure investments. The first phase of an interest rate subsidy scheme allowed a rapid refinancing of enterprise debt contracted at high interest rates during the stabilization phase of 2008. The success of these measures

4. The six banks are WB, ADB, JBIC, KfW, AFD, and KEXIM.

shifts the focus from the size of the stimulus package to the quality of its financing.

Some IDA development policy credits were increased in 2009 to help finance some of these measures, in particular the Eighth Poverty Reduction Support Operation (increased to US\$350 million equivalent and processed using the IDA Fast-Track Facility) and the Program 135 Phase 2 Support Operation for Communes Facing Extreme Hardship in Ethnic Minority and Mountainous Areas (increased to US\$100 million equivalent). In 2010, the first Power Sector Development Policy Operation (US\$200 million from the International Bank for Reconstruction and Development and US\$115 million from IDA) was approved.

Apart from the stresses caused by the global economic situation, new challenges emerge as Vietnam's economy becomes more sophisticated.

The next few years will be critical

Vietnam is likely to complete its transition to a market economy and will have laid the institutional foundations of a middle-income country. Whether those institutional foundations will be strong enough to keep growth sustainable and inclusive as the global economy continues to reel from the ongoing crisis, will depend on policy decisions made during the next few years. This makes it all the more important for donors to sustain a high level of assistance in support of the country's move to middle-income country status.

Mobilizing resources for infrastructure requires stronger frameworks for private participation, including the organization of a market for electricity.

In health, as Vietnam moves through socio-economic and demographic transition, the attention will shift beyond essential preventive health programs towards tackling health system issues of affordable health insurance, efficiency and quality improvements of both basic and more sophisticated health services as well as preparing to tackle increased burden of non-communicable disease.

Enhancing Vietnam's competitiveness and avoiding being caught in middle-income country trap will require continuous upgrading of skills and educational attainment of human capital and developing science and innovation base for high value added industries and services.

Poverty in Vietnam still has a strong regional dimension. However, industrialization, integration in the world economy, urbanization, and other economic and societal shifts will bring new poverty and vulnerability risks for households. Vietnam will need to gradually strengthen social protection systems to better respond to both chronic poverty and shocks,

including by developing policies that more directly address the needs of poor people, to complement poverty reduction policies that focus on poor regions.

Rapid growth and poor compliance with environmental laws have created major environmental problems in Vietnam, in areas such as water and air pollution, depletion of natural resources, and loss of biodiversity. Understanding is growing about what will be the major and negative impacts of climate change on people and the environment. There is an urgent need for more balanced attention to environmental issues in Vietnam.

A more sophisticated economy requires better feedback mechanisms from the people on the quality of public policies, and this means increased transparency and accountability.

Reforms of banking and state-owned enterprises will need to focus on competition and moving quickly towards best practice standards of transparency and good governance; this has become more pressing with

Vulnerability to Climate Change

Vietnam is widely considered one of the highest priority countries in the world for urgent action on climate change, due to its vulnerability to sea level rise and extreme weather events, with the bulk of its population and economic activity in two low-lying deltas.

The government understands the seriousness of these threats to the country's future and development. A National Target Program on Adaptation to Climate Change was approved in 2008, and many sectoral plans or strategies are focused on climate change. Virtually all donors and non-governmental organizations (NGOs) in Vietnam are moving forward with efforts to counter or adapt to climate change. In this context, IDA's role will be pivotal in mobilizing financial resources to Vietnam for both mitigation and adaptation over the next decade. A number of ideas for stand-alone projects or climate change components are being developed. These include enhanced adaptation investments in water resources management, natural disaster risk mitigation, reduction of urban vulnerability to climate change, and in management of coastal resources. On mitigation, the Bank is pursuing important agendas such as supporting the legal and regulatory framework and capacity building for energy efficiency and renewable energy, financing of new renewable energy, and introduction of time of use electricity tariffs.

Vietnam's accession to the WTO and in light of the recent global financial crisis.

Massive urbanization and land conversion and a still weak legal system will amplify opportunities for corruption.

Continued economic growth will depend very much on the Government's ability to tackle these issues over the coming years.

The need for stronger IDA support

Supporting good policy choices, especially for governance, and strengthening government systems are important priorities in the short to medium term. But the cost of implementing these will be high.

Recapitalizing state-owned commercial banks and divesting and reforming large state-owned enterprises will lead to redundancies and require effective social safety net. Funding infrastructure development is another costly priority.

While several quantitative MDGs have been met or are likely to be met, additional resources are critical to ensuring that there is strong quality in these achievements.

Tax revenue alone will not be enough and massive borrowing in international markets could raise the public debt burden beyond prudent levels. Aid on concessionary terms has an important role to play until Vietnam's infrastructure catches up with that of its neighbors and competitors.

Resources are still needed to keep growth inclusive. For most of the period after Doi Moi, reducing poverty was mainly an economic issue. Now, poverty efforts are increasingly focused on ethnic minority groups.

Sustained transfers of funds are needed to ensure that the living standards of these groups do not fall further behind those of the majority.

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